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PUBLIC ADVANTAGES OF HOLDING COMPANIES

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By the term "holding companies," as hereafter used, it is intended to mean only those holding companies which acquire the stocks and other securities of public utilities, and under the term "public utilities" we intend to include only gas, electric light and power, street railway and heating companies, thus excluding any consideration or discussion of holding companies in the industrial or railroad field and also of holding companies in connection with telegraph and telephone utilities, for the reason that with the latter a large factor of their usefulness and value results from inter-community communication, whereas, at this gathering, being a meeting of the mayors of cities, we are interested in the utilities with localized activities directly affecting the prosperity of municipalities and the comfort and convenience of the inhabitants thereof.

So restricted, holding companies are distinctly peculiar, in that their investment is made in the securities of subsidiaries which have come to be generally, if not almost universally, recognized as natural monopolies.

Justice Peckham, in the case of *Willcox vs. Consolidated Gas Co.*, 212 U. S. 19, 49, referring to the Gas Company, said:

It is a corporation which, in fact, as the court below remarks, monopolizes the gas service of the largest city in America and is secure against competition under the circumstances in which it is placed, because it is a proposition almost unthinkable that the city of New York would, for purposes of making competition, permit the streets of the city to be again torn up in order to allow the mains of another company to be laid all through them to supply gas which the present company can adequately supply.

President Wilson has said that "Public Service Corporations are in a very interesting sense natural monopolies."

B. H. Meyer, of the Interstate Commerce Commission and formerly of the Wisconsin Railroad Commission, in his article in the *American Political Science Review* for August, 1911, p. 374, says:

There are few things which the industrial history of advanced nations proves more conclusively than that competition in the field of public utilities has failed to insure reasonably adequate service at reasonable rates.

For many additional citations of the best thinkers in this field, I would refer you to the appendix to the brief submitted on behalf of public utility holding companies to the Interstate Commerce Committee of the U. S. Senate, in the matter of Senate Bill No. 4160.

Of the thirteen states which, in 1910, were the most populous in the Union, eleven have established a public policy in restriction of competition in the public utility field.

The holding companies under consideration tonight, therefore, have none of the vices of holding companies which have been condemned by the courts in connection with railroad, industrial and other enterprises.

Public utility holding companies are not organized to restrain competition or create monopolies. Whilst occasionally they may acquire competitive utilities in one community, this is not the special object and purpose, nor their usual field of activity, but, even in this exceptional case they are not an instrumentality for the elimination of competition, for real competition between public utilities is neither obtainable nor even thinkable and the inevitable outcome of its attempted creation is consolidation and merger of such utilities. The holding company is an unsatisfactory substitute in such instances to accomplish the advantages reachable through actual and complete merger.

The most serious charge brought against holding companies generally and, therefore, including such companies as we are considering this evening is that they afford a most convenient means for over-capitalization. That public utility holding companies like those in the industrial and railroad field are susceptible to this abuse cannot be denied, but, on the other hand, such holding companies do not offer the same opportunities for over-capitalization because the history of investments in public utility corporations has been one of almost uniform growth in the volume and security of the earnings and not one of large fluctuations. The history of these investments, therefore, provides nothing for a would-be promoter's imagination to capitalize, but, aside from this, the capitalization of a holding company has no effect upon the subsidiaries.

The over-capitalization of operating utilities may, and even does, become prejudicial to the public welfare. Such over-capitalization, however, of the operating company itself, is not facilitated in any manner by the instrumentality of the holding company. It can as readily be done and is as a matter of fact more likely to occur where the company's stock is held by individuals.

Unlike large industrial and railroad holding companies, public utility holding companies do not result in the centralization of large power in their officers and directors, for the reason that they are usually so financed as to provide them only with such an amount of working capital as can be profitably employed in temporarily financing the subsidiaries, so that, in adverse times, the bonds and preferred stocks of the subsidiaries need not be sacrificed and so that, even in good times the disposition of the securities of the subsidiaries can be postponed until the investment made therein has demonstrated the increasing earning power of such subsidiaries and the higher market values which their securities should command. They afford no opportunity for shifting business activities from one corporation to another, as in the industrial field a plant here is closed and a plant there operated overtime to meet demands.

On the other hand, these holding companies, representing the ultimate equities in operating public utilities can command capital when the separate operating companies could not so do through the sale of their common stocks, for the reason that any conditions local to any one operating company may destroy the earning power of its common stock temporarily, and this risk makes the investment in such stock more or less speculative, whereas, it is unlikely that such reverses would overtake in the same year all or even a considerable part of 20 or 30 operating companies, whose common stocks are held by the same holding company and whose activities are in widely separated localities. The advancing prosperity and increasing earnings of the many subsidiaries not subject to such set-backs counterbalance and, in fact, in all holding companies of magnitude have uniformly exceeded the deficits from time to time encountered in their various subsidiaries.

It is the law of average making for a greater uniformity of returns and increased security thereof at the cost of a reduction in speculative, abnormally rapid possible growth. Such holding company is based upon the sound historical assumption that while

the utilities of any community by municipal calamity or drastic rate regulation may suffer a temporary or even serious set-back, the average of all municipalities and, therefore, of the utilities serving them will be in the future as in the past one of constant growth and gain.

The Ohio floods brought distress to many public utility companies, resulting in a total stoppage of dividends on their stocks and even in some cases deficits in meeting fixed charges, which caused marked hardships to the individual investors in such properties. The stocks of many other of the public utilities affected by those floods were held by holding companies and, whilst they, as separate properties caused corresponding losses to the holding company which they would have caused had their shares been owned by individuals, the increasing returns on other properties not affected by such calamities caused the holding companies to show, nevertheless, an increasing revenue applicable to their common stocks.

Public utilities, being actual monopolies, are deprived of the vitalizing effect of keen competition so essential to aggressiveness, energy and efficiency. A holding company restores this incentive to its various subsidiaries: for the unobtainable actual competition, it substitutes comparative competition in every department of the operating companies, for the reason that the results obtained by each separate subsidiary are carefully tabulated in parallel columns for comparison with the corresponding results attained by all of the other subsidiaries. These comparative tables, which are forwarded monthly to all of the division heads of each subsidiary, constitute an index of the results obtained and the service rendered and disclose with unerring accuracy which of the subsidiaries are operated in the most efficient and satisfactory manner.

It can be said without fear of contradiction on the part of men of experience that the average of operating economy and efficiency is materially greater in the public utilities which are subsidiaries of large holding companies than in the isolated, unaffiliated companies, locally owned and controlled.

The advantages arising from uniformity of accounting, from the purchasing of material and supplies in volume at wholesale prices, from the use of the greater credit enjoyed by the holding company, are self-evident; whilst, on the other hand, the holding company, by apportioning the expense amongst the aggregate of

its subsidiaries, can provide a staff of consulting and advising engineers of a calibre, ability and experience which separate and isolated companies, except those in the eight or ten of our largest cities, could not afford to command or employ. Such engineering supervision and advice guarantees the installation of the most modern equipment; the introduction of the very latest and best economies and the maintenance and operation of the plant in the most efficient and capable manner.

The holding company becomes a clearing house of the difficulties, the problems, the experiences, the solutions and achievements of each subsidiary and thereby each has the benefit of the cumulative wisdom and experience of all. It is unfortunate that this coöperative helpfulness has not resulted in some association of the holding companies, to the end that the departmental heads of the holding companies might further enlarge their field of knowledge useful in the service of the public, by a mutual interchange of experiences had and of difficulties encountered and overcome.

What has been said, while incomplete, is a sufficient summary of the important features of holding companies in this field necessary to a reasonably accurate understanding of their functions and purposes and should enable us to ascertain what their effect is in respect to public welfare.

Under the term "public welfare" we will not consider the question of investors in public utility securities as such, but the customers, consumers and patrons and the general effect upon the community in which the utility subsidiaries operate.

Technically, as a legal proposition, it would be clear that they have no effect whatever upon the public so considered. The latter are interested: (1) in adequate and efficient service favorably comparable with the best like service given under similar conditions in other communities similarly situated; (2) in reasonable and fair rates, having regard to the location of the property, a fair and proper return on the investments in the community and the conditions of advantage or disadvantage under which the local utility there operates; and (3) in the safety, comfort and convenience of both the public and the employes of the utility. These are the only matters in which the consumers and patrons of a utility are interested. There has never been a case involving any one or more of these three factors before a public service commission in which

the ownership of the shares of stock of the public utility under investigation has been material or even relevant to the inquiry and this is inevitably so, because, if it were otherwise, we would have a different rule for measuring the obligations of a public service corporation determined by the entirely immaterial question as to whether or not the shares were all owned by one individual or many, or by one corporation.

The courts, including the Supreme Court of the United States, have determined that the certificates of stock are merely evidences of a proportionate interest in a corporation: that for all purposes except controversies growing out of the contractual relationship between the stockholder and the corporation itself, the corporation represents each and all of its stockholders and, therefore, the stockholders are never either necessary or even proper parties in any proceeding involving the question of whether or not such company is furnishing adequate and efficient service at fair and reasonable rates with the proper safety, comfort and convenience to the public and its employees.

No power of control or regulation which a state, either directly, or through its legislature, or through a public service commission, or through any other delegated instrumentality, has, in respect of a public service corporation can be lost or curtailed by reason of the foreign ownership of its shares or the aggregate holding thereof by a holding company.

Although, therefore, from the legal viewpoint, holding companies are passive as to their effect upon the public welfare, neither adding nor taking away anything in which the public has an interest or right, when practically considered, they really become momentous factors for public good.

Nobody understands so well as the enlightened manager of a public utility holding company the fact that his subsidiary is deprived of the subtle, but, nevertheless, persuasive influence making for leniency and consideration towards a public service company, inevitably incident to the individual local widely distributed ownership of the securities of a public utility. Every stock and bondholder of such a public service corporation has his friends and these are not willing to join in the hue and cry making unreasonable demands or placing drastic rules and regulations upon a public utility in which local funds are so largely invested. This becomes

the more manifest with reference to the service almost invariably furnished by municipally operated plants, in that the public, being in its entirety interested in the same through the municipal ownership, never expects the same service and will submit to inefficiencies, uneconomies and want of helpfulness never extended to a privately owned and operated company. Again, through the tabulations of the operation of subsidiaries of the public utility companies, the officers and directors of the holding company interested therein have learned to appreciate that the growth and prosperity of the community itself are reflected directly in a corresponding growth and prosperity on the part of the local operating public utilities and that that public service corporation best serves the interests of its security and stockholders and, therefore, of the holding company, which best serves the community's interests. No independently-owned public utility corporation can be as helpful in the upbuilding and serving of its community as one which, by reason of its being owned by a holding company can, through the central managerial, engineering, accounting and commercial departments of such holding company, secure for itself the benefit and advantage of the experience had in other affiliated operating companies. Each measure, therefore, which is found in one community to increase the public good-will, to add to the efficiency of the service and the satisfaction given to the consumer, is promptly made operative in the other public service subsidiaries. It is immaterial whether such improvement in local service is due to altruistic or philanthropic motives, or from the selfish desire to increase revenues, so long as the communities secure the benefit.

The commercial department of these large holding companies in this pursuit of new business for each and all of the subsidiaries is constantly on the watch for business opportunities, is constantly seeking the location of new enterprises in the communities served by one or the other of the holding company's subsidiaries, in order to add to the number of customers and the volume of business and, thereby, through these activities, added growth and prosperity are brought to the communities served. The commercial department of a large holding company is certain to have a wider knowledge of such offering opportunities than it is possible to find in the best organized commercial department of a local, independently-owned public service corporation.

The Conference of American Mayors which is being held in Philadelphia is welcomed by the public utility people. There is nothing so harmful to the public service corporations as a lack of public understanding and comprehension of their functions, their duties and their rights.

The executives of American municipalities are very generally allotted too short a term of office to enable them, with their multitude of duties and obligations, to become thoroughly familiar with the public service corporations and their problems; and, on the other hand, by reason of the peculiar character of these problems of public service operations and difficulties, very few mayors can be expected to bring to such office the special knowledge which this line of business demands and requires. Whilst they and the general public no longer encourage the organization of competitive utilities with their inevitable short-lived rate wars, their subsequent consolidations with inflated security issues and then the impelling and unavoidable necessity for exorbitant rates in return for inefficient service in order to earn interest and dividends upon such securities, they do not understand and appreciate, on the other hand, the hazards of the business due to the tremendous strides made by invention and discovery, causing equipment, plant and machinery even to become uneconomical before an appreciable percentage of its normal usefulness and life is spent. They overlook the fact that installations have to be made with reference to the existing demand for service and a reasonable regard for the prospective growth: that the company cannot afford, nor would it be justified in making installations sufficiently large to be capable of meeting the demands for service during the probable full physical life of the installation and that, as the community and its demands grow from the standpoint of operating costs it is cheaper to abandon a small unit and install a large one, than simply to add successive units of limited capacity and that, therefore, the rule of law generally relied upon, that confiscation only occurs when the utility is deprived of a fair return upon the present value of its property engaged in the public service is unfair to the utility and injurious to the community that it serves.

In the face of an increase in the cost of materials, supplies and labor used by the public service corporation proportionate to the increased costs of such commodities and labor in other business

channels, the public service corporations have, nevertheless, steadily and uniformly reduced the actual cost of the service or commodity furnished the public. The greatest reductions in such charges against the public have occurred in the last twenty years and contemporaneously, therefore, with the growth and development of public utility holding companies. These companies have furnished the opportunity and the means for experimenting with every new idea that gave reasonable promise of better service at lower cost.

In the last twenty-five years, the average price of gas, for example, in Massachusetts has fallen $47\frac{1}{2}$ per cent; whilst the average price of electric light per kilowatt-hour in the last twenty years has decreased 48 per cent.

In the meantime, the effective usefulness of the gas, itself, has been materially increased, through the introduction of the incandescent mantle and the improvements of gas stoves, ranges and heaters, so that, with the reduced price per thousand cubic feet, there has also followed a reduced consumption to accomplish the same results.

In the electric field, the tungsten filament lamp has resulted in an energy saving of 75 per cent as compared with that used with the old carbon filament, whilst the efficiency of motors and the elimination of transmission losses in conductors have almost in the commercial field reached perfection.

The street car fare, it is true, has remained generally uniform at 5 cents, but, for the nickel today, the patron has the quick, comfortable, well-heated, well-lighted, electric rapid transit car, in place of the slow, uncertain, unclean, poorly illuminated and often unheated horsecar. Universal transfers have been generally adopted, whilst the street railways have extended their suburban lines to such an extent as to even reach and join the suburban lines from other municipalities, thus forming interurban connections, competing, through frequency and cheapness of their service, with the existing steam roads. The growth of the communities in which the street railways operate has caused the average length of ride to increase materially, without any advance in the fare.

That this tremendous advance in the public service field has a direct relationship to holding companies and that its being contemporaneous with their development is not a mere coincidence is evidenced by the fact that of approximately \$4,000,000,000

invested in street railways, 81.4 per cent is organized into or affiliated with holding companies; of the \$2,100,000,000 of securities outstanding in the electric light and power business, 82½ per cent is organized into or affiliated with holding companies; that of the \$1,300,000,000 of securities outstanding in gas companies, over 66 per cent is organized into or affiliated with holding companies, so that, out of approximately \$7,500,000,000 of gas, electric and traction capital, 78.5 per cent (over \$5,900,000,000) is now organized into or affiliated with about 140 independent holding companies, whose securities are today known and bought throughout this country and Europe.

Contemporaneously with the holding company's standardization of service, methods of accounts and financing of public utilities, there has come a recognition on the part of the experts as to the integrity, security and attractiveness of public utility investments.

The last annual report of the comptroller shows that for the year 1913 the investment holdings of the national banks in public utility issues had increased nearly 20 per cent over their aggregate previous holdings, whilst their investments in railroad securities decreased over 6 per cent.

This all means a growing confidence on the part of financial experts and of the investing public, that the attitude of the communities and municipal officials towards public utilities, and of those utilities towards the public, is gradually being established upon a basis of mutual understanding, certain to result in even-handed justice.